Office-Supreme Court, U.S.
FILED
MAY 24 1963
JOHN F. DAVIS, CLERK

SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. [redacted] 159

EGON D. AREND and MELA K. AREND,
Petitioners,

v.

PERRY DeMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON),
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

JAY H. TOPKIS
Attorney for Petitioners
575 Madison Avenue
New York 22, N. Y.

PAUL WEISS RIFKIND WHARTON
& GARRISON
and
GERALD D. STERN
575 Madison Avenue
New York 22, N. Y.
and
MORRIS J. GALEN
Public Service Building
Portland 4, Oregon
Of Counsel

INDEX

	PAGE
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes and Rule Involved	4
Statement of the Case	5
Reasons for Granting the Writ	
1. The Standard Used by the Court of Appeals to Determine the Propriety of the Present Investigation Was Improper and Conflicts With Decisions of Other Circuits	8
2. The Reversal of the District Court's Judgment Was Erroneous Even Under the Standard Adopted by the Court of Appeals	18
3. The Court of Appeals Erred in Ruling that the Fourth Amendment Was Not Applicable	20
Conclusion	24
Appendix A (Judgment of the Court of Appeals)	1a
Appendix B (Opinion of the Court of Appeals)	2a
Appendix C (Memorandum Opinion of the District Court)	19a
Appendix D (Opinion of the District Court Denying Respondents' Summary Judgment Motion)	20a
Appendix E (Opinion of the District Court Denying Petitioners' Summary Judgment Motion)	26a

CITATIONS

PAGE

CASES

In re Andrews' Tax Liability, 18 F. Supp. 804 (D. Md. 1937) 13, 17

Application of Howard, 210 F. Supp. 301 (W. D. Pa. 1962) 12

Application of Magnus, 299 F. 2d 335 (2d Cir.); *cert. denied*, 370 U. S. 918 (1962) 9

Application of Magnus, 311 F. 2d 12 (2d Cir. 1962), *cert. denied*, 31 U. S. L. Week 3353 (April 29, 1963) 9

Application of United States (In re Carroll), 246 F. 2d 762 (2d Cir.), *cert. denied*, 355 U. S. 857 (1957) 11

Brex v. Smith, 146 Atl. 34 (N. J. Ch. 1929) 23

Holland v. United States, 348 U. S. 121 (1954) 19, 20

Jones v. United States, 362 U. S. 257 (1960) 21

Lash v. Nighosian, 273 F. 2d 185 (1st Cir. 1959), *cert. denied*, 362 U. S. 904 (1960) 11

Martin v. Chandis Securities Co., 128 F. 2d 731 (9th Cir. 1942) 9, 17

McDermott v. John Baumgarth Co., 286 F. 2d 864 (7th Cir. 1961) 14

O'Connor v. O'Connell, 253 F. 2d 365 (1st Cir. 1958) 10, 11, 14, 16

Oklahoma Press Publishing Co. v. Walling, 327 U. S. 186, 213 (1946) 14, 15

Pacific Mills v. Kevefick, 99 F. 2d 188 (1st Cir. 1938) 9, 17

Silverman v. United States, 365 U. S. 505 (1961) 21

PAGE

Thomas v. *Commissioner*, 261 F. 2d 643 (1st Cir. 1958) 20

U. S. Aluminum Siding Corp. v. *Eshleman*, 170 F. Supp. 12 (N. D. Ill. 1958) 13

United States v. *Austin*, 209 F. Supp. 101 (M. D. N. C. 1962) 13

United States ex rel. Sathre v. *Third Northwestern Nat'l Bank*, 102 F. Supp. 879 (D. Minn. 1952), appeal dismissed, 196 F. 2d 501 (8th Cir. 1952) 14, 17

Wall v. *Mitchell*, 287 F. 2d 31 (4th Cir. 1961) 13

Zimmermann v. *Wilson*, 81 F. 2d 847 (3d Cir. 1936) 21, 22

Zimmermann v. *Wilson*, 105 F. 2d 583 (3d Cir. 1939), affirming, 25 F. Supp. 75 (E. D. Pa. 1938) 12, 17, 21, 22

STATUTES

28 U. S. C. § 1254(1) 2

28 U. S. C. § 1340 ..... 2, 5

26 U. S. C. § 7602 ..... 3, 4

26 U. S. C. § 7605(b) 3, 4, 8, 11, 17, 18, 21

RULE

Rule 52(a), F. R. C. P. 3, 5, 18

MISCELLANEOUS

61 Cong. Rec. 5202, 5855 15

S. Rep. No. 275, 67th Cong., 1st Sess. 31 (1921) 15

Handbook for Internal Revenue Agent ¶ 10.01 19

Internal Revenue Manual § 4567 19

Note, 10 Hastings L. Rev. 211, 213-14 (1958) 17

PAGE

Note, 60 Mich. L. Rev. 781, 791 (1962) 23

Note, 45 Yale L. Rev. 1523 (1936) 23

73 Banking L. J. 163 (1956) 23

American Bar Association, *Tax Fraud Cases—Practice and Procedure* 14 (1951) 19

8 Mertens, *Law of Federal Income Taxation* § 47.48 (Cum. Supp. 1962) 16

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

EGON D. AREND and MELA K. AREND,
Petitioners,

v.

PERRY DEMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON),
Respondents.

No. .....

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners Egon D. Arend and Mela K. Arend respectfully pray that a writ of certiorari be issued to the United States Court of Appeals for the Ninth Circuit to review the judgment of that Court dated January 24, 1963 (reprinted in Appendix A hereto), reversing a judgment in petitioners' favor entered in the United States District Court for the District of Oregon.

Opinions Below

The opinion of the United States Court of Appeals for the Ninth Circuit (R. 136-149) is reported at 313 F. 2d 79 (1963) and is reprinted in Appendix B hereto. The memorandum opinion of the United States District Court

for the District of Oregon granting the permanent injunction in petitioners' favor (R. 53-54) is not reported but is reprinted in Appendix C hereto. That Court's opinion denying respondents' motion for summary judgment (R. 34-41) is reported at 181 F. Supp. 761 (1962) and is reprinted in Appendix D hereto. That Court's opinion denying petitioners' summary judgment motion (R. 43) is not reported but is reprinted in Appendix E hereto.

Jurisdiction

The judgment of the Court of Appeals was entered on January 24, 1963. A petition for rehearing was denied by the Court of Appeals on February 26, 1963. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

Questions Presented

1. The Court of Appeals here reversed a District Court judgment restraining Internal Revenue employees from further examination of petitioners or third persons dealing with petitioners with respect to petitioners' tax liability for any year prior to 1955. The District Court found that petitioners' 1946 and 1948 returns and relevant papers were examined and audited by the Internal Revenue Service in 1948 and 1950, respectively, and additional assessments were levied and paid for 1946. The District Court also found that, when in August 1958 the Internal Revenue Service issued a summons to a bank for production of all records of petitioners' financial activities with respect to petitioners' alleged tax liability for 17 years going back to 1940, the statute of limitations barred any additional assessment against petitioners for any year prior to 1955

except for fraud, and the Service did not have "any reasonable grounds or other proper cause to find or suspect that any fraud existed" with respect to petitioners' returns for those years. In reversing the District Court's judgment, the Court of Appeals held that in these circumstances the District Court "lacked power" to issue the injunction in question. Was the Court of Appeals correct that the District Court lacked such power?

2. Under 26 U. S. C. §§ 7602 and 7605(b), must the Internal Revenue Service have reasonable grounds or other proper cause to find or suspect that taxpayers have committed fraud if the Service seeks a new investigation of taxpayers' returns for years which are closed by the statute of limitations absent fraud and for some of which there have been audits and an additional assessment levied and collected?

3. The finding of the District Court that there were no reasonable grounds or other proper cause to find or suspect fraud in the closed years is supported by substantial evidence, and the Court of Appeals did not purport to hold the finding to be clearly erroneous. Nonetheless, the Court of Appeals ruled that the renewed examination was not "unnecessary" under 26 U. S. C. § 7605(b). Was this ruling error in light of Rule 52(a), F. R. C. P.?

4. Does the Fourth Amendment afford taxpayers protection against renewed investigation by the Internal Revenue Service where some of the years in question have been previously audited and all of the years are closed by the statute of limitations absent fraud and the Service does not have any reasonable grounds or other proper cause to find or suspect that the taxpayers have committed fraud?

The Statutes and Rule Involved

The statutes involved are 26 U. S. C. §§ 7602 and 7605(b).

26 U. S. C. § 7602 provides:

> "EXAMINATION OF BOOKS AND WITNESSES
>
> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and
>
> (3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry."

26 U. S. C. § 7605(b) provides:

> "*Restrictions on Examination of Taxpayer.*—No taxpayer shall be subjected to unnecessary exami-

> ifation or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary."

The rule involved is Rule 52(a), F. R. C. P.:

> ". . . Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. . . ."

Statement of the Case

Petitioners are husband and wife, residing in Portland, Oregon (R. 45). They here sued certain employees of the Internal Revenue Service (hereinafter "respondents") and a Portland bank in the District Court for the District of Oregon. The suit was brought about by "a new investigation" of petitioners' alleged tax liability for years going back to 1940—23 years ago (R. 137). Petitioners sought an injunction restraining respondents from examining petitioners or third parties with respect to petitioners' tax liability for any year prior to 1955 and restraining the bank from disclosing information concerning transactions by or with petitioners prior to 1955 (R. 10-11). Jurisdiction was based on 28 U. S. C. § 1340 (R. 3, 55).

In 1948, an Internal Revenue deputy collector examined petitioners' 1946 return and relevant papers. As a result, additional assessments were levied and paid (R. 57). In November 1950, another Internal Revenue deputy collector audited petitioners' 1948 return and relevant papers (R. 58).

In the spring of 1957, respondent DeMasters, an Internal Revenue agent, began "a new investigation" into

petitioners' returns for the years 1940 through 1956 (R. 58, 137). He began to inquire into petitioners' net worth as reflecting their income in those years (R. 33).

Petitioners cooperated with agent DeMasters with respect to his investigation as to years not barred by the statute of limitations (R. 47, 58, 137). When the agent persisted in his inquiry into closed years and sought access to petitioners' records without limitation as to date, petitioners' attorney notified the agent that such investigation was unjustified and unnecessary and beyond his authority (*Ibid.*).

On August 14, 1958, agent DeMasters caused a summons to be served on the bank for production of records on the alleged tax liability of petitioners over a 17-year period including the years 1940-1954. It called for "all records" pertaining to financial, loan and investment activity of petitioners, their children and a sole proprietorship formerly owned by one of the petitioners (R. 56-57).

Petitioners commenced this action on August 18, 1958. The bank did not answer or otherwise appear in the action. By orders dated March 1, 1960 and July 21, 1961, the District Court denied summary judgment motions by respondents and petitioners, respectively (R. 41, 43).

In its opinion on respondents' motion, the District Court held that it properly had jurisdiction over the action. Citing decisions by the First, Fifth, and Sixth Circuits—as well as the Ninth—the Court further declared:

> "The better-reasoned cases require that the Commissioner show that there is some reasonable suspicion or probable cause to believe fraud exists prior to the court directing compliance with a summons issued by the Commissioner or his agents, or to show that there is some justifiable reason for such investigation when there has been an audit and adjustment already" (R. 39; App. D, p. 23a).

It added:

> "If there is arbitrary action on the part of the defendants, an injunction should issue to protect the plaintiffs from unreasonable and irreparable damage; however, if there is reasonable grounds to suspect fraud on the part of the taxpayers, the defendants should have the opportunity to discover such fraud during the years involved" (R. 40-41; App. D, p. 25a).

With the issues thus carefully framed, the District Court held a full hearing and, on the basis of extensive findings of fact, granted petitioners the injunction they sought.

The findings of fact included the following:

"XIII

> "The period covered by the summons involved eighteen years, the earliest of which is 1940. The period during which Commissioner could assess additional income tax against plaintiffs for any calendar year prior to 1955 has expired, except where fraud is involved."

* * *

"XV

> "The defendants immediately prior to the issuance of said summons did not have any reasonable grounds or other proper cause to find or suspect that any fraud existed with respect to any of the returns filed by the petitioners for the years that are now closed by the statute of limitations, to wit: The years prior to 1955" (R. 58-59).

On appeal, the Circuit Court reversed the judgment based on these findings (R. 150). The Circuit Court ruled

that the Fourth Amendment had no application. It also ruled that the prohibitions of 26 U. S. C. § 7605(b) do not require that the Internal Revenue Service have reasonable grounds or probable cause to suspect fraud in order to investigate into years closed by the statute of limitations absent fraud. The Court ruled that there had been a showing that the decision to proceed was not arbitrary and that "no more was required" (R. 149). As a result, while the Circuit Court rejected respondents' contention that a District Court has no power to issue an injunction of the type sought in any circumstances, the Circuit Court concluded that "the Court lacked power to do so in the circumstances of this case" (R. 136).

Reasons for Granting the Writ

1. The Standard Used By the Court of Appeals to Determine the Propriety of the Present Investigation Is Improper and Conflicts With Decisions of Other Circuits.

In reaching its decision to reverse the District Court judgment, the Court of Appeals used an improper standard for determining whether the investigation of petitioners should proceed. That improper standard clearly conflicts with decisions of other Circuits.

Two matters should be noted preliminarily.

First, the initial provision of 26 U. S. C. § 7605(b) constitutes an absolute statutory limitation on the Commissioner's basic power of investigation, and is not simply a privilege given to a taxpayer with respect to inquiries made of him personally. Both Courts below correctly so ruled on this point.* The Court of Appeals said:

*As the Court of Appeals recognized in its opinion (R. 142), there is also a conflict among the Circuits on this point—which highlights the general confusion in this area. For example, the decision of the Court below on this point conflicts with that of the

> "The command is unequivocal. We have held that it constitutes 'a limitation on the power' of the tax collecting authorities; appellants, in consequence, had 'no power to make an unnecessary examination or investigation' [citing *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731, 735-36 (9th Cir. 1942)]. As we have said, if appellants violated this statutory limitation upon their power, the present suit is maintainable. The difficult problem, of course, is that of determining the scope of the limitation: what is meant by an 'unnecessary' investigation" (R. 141-142).

Second, the Court of Appeals did not purport to set aside any of the District Court's findings of fact. It did not rule any finding to be clearly erroneous. Cf. Rule 52(a), F. R. C. P. Thus, it must be taken as established that with respect to the closed years—two of which had been previously audited—respondents did not have any reasonable grounds *or other proper cause* to find or suspect fraud (R. 59).

With this background, the Court of Appeals faced "the difficult problem" of the scope of the § 7605(b) limitation and the showing necessary to permit a new investigation. The Court ruled that there need not be a showing of "probable cause, or any cause at all," to believe that there is fraud where the Commissioner seeks to investigate a return for a tax year as to which, unless fraud is shown, the statute of limitations has barred additional assessment (R. 145). The Court apparently concluded that mere "sus-

---

Second Circuit in *Application of Magnus*, 299 F. 2d 335 (2d Cir.), *cert. denied*, 370 U. S. 918 (1962), which held that the § 7605(b) prohibition "applies only to inquiries made of the taxpayer personally, and does not extend to inquiries made of third persons even though concededly part of an investigation directed solely to the taxpayer's liability" (R. 142). See, also, *Application of Magnus*, 311 F. 2d 12 (2d Cir. 1962), *cert. denied*, 31 U. S. L. Week 3353 (April 29, 1963). But see *Pacific Mills* v. *Kenefick*, 99 F. 2d 188, 189 (1st Cir. 1938).

picion"—whether or not reasonable or probable or proper—is enough (*Ibid.*). All that is required is that the Commissioner "not act arbitrarily" (R. 147, 149).

This decision was erroneous and conflicts with the decisions of several other Circuits.*

For example, the First Circuit in *O'Connor* v. *O'Connell*, 253 F. 2d 365 (1st Cir. 1958), held that the IRS must establish to the Court's satisfaction that there is "probable cause to believe that the taxpayer was guilty of fraud in a statute barred year" and that a showing of a "*bona fide* suspicion of fraud" is not enough (*Id.* at 369, 370). The Circuit Court there reversed a District Court order directing compliance with a Special Agent's 1957 summons to a taxpayer with respect to his and his wife's 1943-1947 tax liabilities. The issue as phrased by the Circuit Court:

> ". . . The question is: Do the taxing authorities only need to show the enforcing court that they entertain a *bona fide* suspicion of fraud on the part of the taxpayer for those years, or must they establish to the satisfaction of the court that there is probable cause or a reasonable basis for it to believe that in those years the taxpayer perpetrated a fraud upon the revenue?" (*Id.* at 369).

The Circuit Court's answer was:

> "To make the Congressional purpose expressed in § 7605(b) to protect taxpayers from unnecessary examinations truly effective we think the Secretary or his delegate, when a court order is needed to enforce compliance with a summons to testify as to a 'closed' year, should be required to establish to the court's satisfaction that there is probable cause for an investigation into such a year" (*Id.* at 370).

*The Court of Appeals' opinion itself notes the conflict (R. 145-146, particularly n. 28).

The First Circuit expressly rejected the contention that under § 7605(b) "all that the Secretary or his delegate needs to show is the honesty of his subjective belief that fraud existed in such a year" (*Id.* at 369). To hold otherwise, said the Court, would mean that "the necessity for an examination into a closed year would for all practical purposes be left to administrative determination and § 7605(b) would be relegated to hardly more than a pious exhortation directed to the tax authorities" (*Id.* at 369-70).

In so holding, the First Circuit Court of Appeals noted that although the Second Circuit in *Application of United States (In re Carroll)*, 246 F. 2d 762 (2d Cir.), *cert. denied*, 355 U. S. 857 (1957), "found no need to answer this precise question it nevertheless gave rather detailed consideration to the conflicting authorities bearing on it" (253 F. 2d at 369).*

Subsequently, in *Lash* v. *Nighosian*, 273 F. 2d 185 (1st Cir. 1959), *cert. denied*, 362 U. S. 904 (1960), the First Circuit reaffirmed and amplified the *O'Connor* test. The District Court had ordered enforcement of a 1958 IRS summons to a corporate taxpayer with respect to its 1952-55 tax liability, on a finding that there was " 'probable cause' to believe that the taxpayer's returns for the 'closed' years were fraudulent" (273 F. 2d at 187). In affirming, the First Circuit stated:

> "In O'Connor v. O'Connell supra we used the substantially synonymous phrases, see footnote 93 of Draper v. United States, 1959, 358 U. S. 307, 310,

*In *Application of United States (In re Carroll)*, *supra*, the Second Circuit stated: "We are not now called upon to resolve the apparent conflict between the cases dealing with what the tax authorities must show to warrant examination of the taxpayer and others relative to matters which may be barred by the statute of limitations" (246 F. 2d at 765). The decisions of that Circuit are inconclusive and, as the Court below noted, have "treated the question as still open" (R. 146).

> 79 S. Ct. 329, 3 L. Ed. 2d 327, 'probable cause' and 'reasonable grounds' in their generally accepted meaning in other contexts. In using the familiar phrases we meant to imply that in ordering enforcement of a summons the district court should apply the same test that it would apply in deciding whether an arrest by an officer without a warrant, and perhaps his incidental search of the person of his prisoner, complied with constitutional or statutory requirements" (273 F. 2d at 189).

The Third Circuit decisions also conflict with that of the Circuit Court below. In *Zimmermann* v. *Wilson*, 105 F. 2d 583, 586 (3d Cir. 1939), affirming 25 F. Supp. 75 (E. D. Pa. 1938), the Court of Appeals concurred in the District Court's view that the test is one of "probable cause" or "reasonable ground of 'suspicion of fraud.'" More recently, in *Application of Hazard*, 210 F. Supp. 301 (W. D. Pa. 1962), the Court explained a decision it had rendered quashing an IRS summons as to the years 1956-1958 but not as to 1959 (a year on which the statute of limitations had not run, even absent fraud). It stated that it accepted the *Zimmermann* case

> "to the effect that when a reinvestigation is made under 26 U. S. C. § 7605(b), of a tax year as to which the statute of limitations has run except with respect to fraud violations, the mere *ipse dixit* of the internal revenue official that reexamination is 'deemed necessary' is not conclusive; that the Government must set forth facts (not mere conclusions or opinions) sufficient to convince the Court that reasonable ground exists to suspect fraud" (210 F. Supp. at 303).

The Fourth Circuit in *Wall* v. *Mitchell*, 287 F. 2d 31 (4th Cir. 1961), stated:

> "We are well aware of the conflict among the several circuits relative to the showing of suspected fraud required from the Internal Revenue Service in such cases, but we do not find it necessary to make a choice of criteria at this time. Here, the District Judge made a finding that there was probable cause to suspect fraud in connection with the income tax returns filed by the taxpayer for the years in question" (*Id.* at 31-32).

However, both earlier and subsequent District Court opinions in the Fourth Circuit support the "probable cause" requirement. *E.g., In re Andrews' Tax Liability*, 18 F. Supp. 804, 805, 807 (D. Md. 1937); *United States* v. *Austin*, 209 F. Supp. 101, 106 (M. D. N. C. 1962).

The Seventh Circuit also appears to require probable cause. In *U. S. Aluminum Siding Corp.* v. *Eshleman*, 170 F. Supp. 12 (N. D. Ill. 1958), the Court directed a hearing to determine if an IRS examination was necessary. It ruled that the IRS does not have "untrammeled discretion" and since its "discretion is limited, whether or not it has been properly exercised must be judged by the Court" (*Id.* at 14). On the question of what showing the Government must make, the Court observed:

> ". . . It is not strange that there should be disagreement on this point, since the relevant cases are not at all clear. . . .
>
> ". . . [T]he affidavits, assuming their truth, are far short of establishing reasonable grounds for suspecting fraud. They refer to 'another' government agency, and 'unconfirmed information'. This is not enough to convince the Court that there is a 'reasonable basis' for the agents' belief that fraud has been committed; and that is the requirement" (*Id.* at 15).

In *McDermott* v. *John Baumgarth Co.*, 286 F. 2d 864 (7th Cir. 1961), the District Court had found after a hearing that there were "reasonable grounds" to suspect fraud as to two of the four years covered by the "summons" there in issue and enforced the summons only as to those years. The Court of Appeals affirmed. It upheld the District Court's refusal to infer that if fraud was committed in 1951-52, some of the fraudulent practices continued in later years.

Finally, the Eighth Circuit view is reflected by *United States ex rel. Sathre* v. *Third Northwestern Nat'l Bank*, 102 F. Supp. 879, 882 (D. Minn.), appeal dismissed, 196 F. 2d 501 (8th Cir. 1952), where the Court approved the test "of whether the facts show a reasonable ground of suspicion or probable cause for the examination to ascertain if there has been fraud."

We submit that in the conflict among the Circuits, the probable cause view "is supported by the better reason." *O'Connor* v. *O'Connell*, *supra*, 253 F. 2d at 369.

The Court below regarded the § 7605(b) interdiction of "unnecessary" investigation as meaning no more than the general judicial limitations placed on enforcement of administrative subpoenas (R. 147). But the result of such a view is that the express Congressional interdiction really adds nothing to the taxpayer's protection.

The Court below relied on cases dealing with first investigations by administrative bodies (R. 144-145, 147). In so doing, the Court disregarded two vital considerations. First, after the passage of 18 years and after two audits and one additional assessment, the IRS cannot legitimately be said to be "at the threshold of inquiry." *Oklahoma Press Publishing Co.* v. *Walling*, 327 U. S. 186, 213 (1946). Second, the cases on which the Circuit Court relied did not

involve a statute such as § 7605(b) designed by Congress for the citizen's protection.

The statute in question was enacted to provide limitations with respect to new examinations many years after the fact. The expressed concern of the legislators was with "re-examination" (61 Cong. Rec. 5202), "another examination" (*ibid.*), "further examination" (*id.* at 5855), "repeated visits of tax examiners" (*ibid.*) and "unnecessarily frequent examinations and investigations by revenue agents" (S. Rep. No. 275, 67th Cong., 1st Sess. 31 (1921)). And the legislators felt that there should be "good cause for a re-examination" (61 Cong. Rec. 5202).

While the Court below professed that it is not apparent why more should be required of the Commissioner for a new examination into ancient—and once-examined—history than is required for an initial examination within the period of the statute of limitations (R. 145), it later noted that there is "a significant change in the relevant balance of public and private interests which takes place with the running of the statute of limitations" (R. 149). With the running of the statute, the Government's need for unencumbered access to facts decreases at the same time that the burden and hardship of further investigation on the taxpayer increases. As the Circuit Court below recognized:

> "The government's need for speedy and unimpeded access to the facts is diminished when the problem shifts from that of checking the accuracy of the returns of sixty million taxpayers within the relatively short period of limitations, to that of ferreting out the rare instance of liability for fraud which can never be barred by the passage of time. From the taxpayer's point of view, an inquiry which can be readily met when memories are clear and records readily available, may become difficult to satisfy

with a lapse of time, possibly extending, as in the present case, to a score or more of years" (R. 149).

The First Circuit in the *O'Connor* case, *supra*, also noted the significance of the running of the statute in reaching a conclusion opposite that of the Circuit Court below:

> "As the years pass, however, the burden of such examinations on the taxpayer increases, for memories fade, records may be lost or mislaid, indeed to conserve space honest taxpayers may well destroy their records relating to years as to which the statute of limitations has run, and persons who have assisted taxpayers in preparing their returns may die, move away, or for one reason or another be no longer available" (253 F. 2d at 369).

It then stated:

> "We may well assume that considerations such as these had weight with Congress when it legislated in § 7605(b) to curb excessive administration zeal by protecting taxpayers from unnecessary examination and investigation" (*Ibid.*).*

The requirement of "probable cause" for a belief or suspicion of fraud in otherwise closed years simply gives the taxpayer the protection which Congress intended him to have:

> "We think Congress intended to give taxpayers this much protection when the investigation of their returns may reach far back into the past, in this case fourteen years, and in some cases perhaps even

---

*8 Mertens, *Law of Federal Income Taxation* § 47.48 (Cum. Supp. 1962), which praises the *O'Connor* case as "ably considered" (p. 137), also says that it contains "an excellent analysis of the considerations which Congress had in mind in enacting this provision" (p. 141).

further,* and that to require such a showing does not impose too heavy a burden upon the tax authorities or unduly restrict or hamper them in tax enforcement" (*Id.* at 370).

The inclusion of § 7605(b) in the 1954 Internal Revenue Code—the third re-enactment of provisions dating back to 1921 (42 Stat. 310 (1921))—came after several decisions holding these provisions to constitute limitations on the IRS power of investigation and adopting or approving the probable cause requirement for tax years closed absent fraud. *E.g., United States ex rel. Sathre v. Third Northwestern Nat'l Bank*, 102 F. Supp. 879 (D. Minn. 1952), appeal dismissed, 196 F. 2d 501 (8th Cir. 1952); *Martin v. Chandis Securities Co.*, 128 F. 2d 731 (9th Cir. 1942); *Zimmermann v. Wilson*, 105 F. 2d 583 (3d Cir. 1939); *Pacific Mills v. Kenefick*, 99 F. 2d 188 (1st Cir. 1938); *In re Andrews' Tax Liability*, 18 F. Supp. 804 (D. Md. 1937). This further "evidences the legislature's intent that it [§ 7605(b)] should serve to curtail the investigatory powers of the Bureau of Internal Revenue" and give the taxpayer the protection afforded by the probable cause requirement. Note, 10 Hastings L. Rev. 211, 213-14 (1958).

The basic questions here at issue—the extent of permitted IRS intrusion into an individual's affairs and the protection granted by Congress with respect to "closed" tax years—are of far-reaching and recurring significance. The *O'Connor* decision was hailed as providing a "greatly needed standard or test"—"a just result using sound legal reasoning" (*Id.* at 211, 214). The decision of the Court below now creates a clear conflict among the Circuits as to the meaning of a statute whose nation-wide application should be uniform.

---

*Eighteen years in the present case; or twenty-three years from today.

2. The Reversal of the District Court's Judgment was Erroneous Even Under the Standard Adopted by the Court of Appeals.

In view of the findings made by the District Court, the reversal of that Court's judgment was erroneous even if the meaning and scope of § 7605(b) is as expressed by the Court of Appeals. That reversal necessarily violated Rule 52(a) of the Federal Rules of Civil Procedure.

The showing made to the trial Court by the Government was not sufficient to justify the "new investigation" whether judged by a "non-arbitrary" or "rational judgment" test or by a "probable cause" or "reasonable ground" test. And the District Court found not only that respondents did not have "any reasonable ground" to find or suspect fraud, but also that they did not have any "other proper cause" for such a finding or suspicion (R. 59). This finding by the Judge who heard the evidence was not set aside by the Court of Appeals, as it could not properly be under Rule 52(a).

Without any proper cause to suspect fraud, the IRS decision to proceed must be deemed to have been arbitrary. A decision not based on any proper cause cannot legitimately be said to have been reached "as a matter of rational judgment" (R. 149).

The testimony and evidence on which the trial Judge based his decision to grant petitioners equitable relief abundantly establish that this search for "the rare instance of liability for fraud" (R. 149) was supported only by conjecture and excessive zeal. For example:

1. The Government offered no indicia or evidence of fraud. Its "justification" rested in a showing of the possibility of some understatement of income in the years in question. As agent DeMasters candidly stated:

> "I do not conclude anything. I am only of the position that it is entirely possible that these taxpayers understated their income for these years" (R. 101).

He further testified that he was not satisfied in his own mind that there was any omitted income (R. 99).* In any event, the decisions of this Court reject any inference or suspicion of fraud from mere understatement of income—let alone from the possibility of such understatement. See, *e.g., Holland* v. *United States*, 348 U. S. 121 (1954).

2. The agent himself expressed doubt as to whether his figures entitled him to proceed: ". . . I was not convinced that this would give me grounds to investigate at that moment" (R. 87).

3. The agent's net worth analysis "was merely an estimate"—"no attempt is made to stand on this statement" (R. 88). DeMasters admitted that the figure he used for the taxpayers' opening net worth was "the figure that entered my head"—"purely an estimate" (R. 111).

4. Agent DeMasters further admitted that

(a) He incorrectly computed petitioners' closing mortgage liability (R. 87-88);

(b) He made no allowance for petitioners' receipt of non-taxable proceeds from a personal injury claim (R. 113);

---

*It is significant to note that, assuming proper departmental practice was followed in this case, agent DeMasters must not have discovered "what he believes to be an indication of fraud" (Handbook for Internal Revenue Agents, ¶ 10.01) or "any" indication of fraud" (Internal Revenue Manual § 4567). See, also, American Bar Association, *Tax Fraud Cases—Practice and Procedure* 14 (1951).

(c) He made no allowance for funds which he had been informed petitioners brought with them to this country in 1939 and invested in assets held at the close of the period (R. 16, 89, 113-114);

(d) He made no allowance for petitioners' receipt of money from recovery of assets in Czechoslovakia in 1945 and 1948 (R. 117-118); and

(e) He did not know whether petitioners had any money in a safe deposit box at the start of the period or whether they used such money to acquire assets they said they had at the close of the period (R. 114-115).

5. Agent DeMasters conceded that the post-1950 returns all "appear to be correct," and no claim was made that an examination of closed years was needed or sought in connection with an examination of years not barred by the statute. (R. 121, 147.)

It is clear that the Government's attempted showing of "justification" runs afoul of all basic legal and logical principles for showing unreported income by a net worth approach. See, *e.g.*, *Holland* v. *United States*, 348 U. S. 121 (1954); *Thomas* v. *Commissioner*, 261 F. 2d 643 (1st Cir. 1958).

In short, the record shows no proper justification for a suspicion of unreported income, let alone of fraud. The District Court's finding of no proper cause at all to suspect fraud is amply supported by substantial evidence. And that finding necessarily means that the new investigation was improper even under the standard adopted by the Court of Appeals.

3. The Court of Appeals Erred in Ruling that the Fourth Amendment Was Not Applicable.

Petitioners contended in the District Court that they were entitled to relief from the further IRS investigation

under the Fourth Amendment, as well as under § 7605(b), because respondents' action in the circumstances of this case constituted an unreasonable search and seizure.

In reversing the District Court's judgment in favor of petitioners, the Court of Appeals ruled that the Fourth Amendment was not applicable because the IRS summons was directed to the bank and not to petitioners.*

That decision was erroneous and in conflict with a holding of the Third Circuit. *Zimmermann* v. *Wilson*, 81 F. 2d 847 (3d Cir. 1936).

The Court below recognized that "Fourth Amendment rights do not depend on nice distinctions of property law" (R. 140 n. 11). See *Jones* v. *United States*, 362 U. S. 257 (1960); *Silverman* v. *United States*, 365 U. S. 505 (1961). It ruled, however, that "the taxpayers had no interest in the bank's records of the kind the Fourth Amendment was intended to protect" (*Ibid.*). We respectfully submit that this ruling was not correct. In the Fourth Amendment sense, we believe, these documents were private papers in which petitioners had a protectible interest—they were papers concerning petitioners' own private transactions with and through fiduciaries.

In *Zimmermann* v. *Wilson*, *supra*, the Third Circuit Court of Appeals reversed a dismissal of a complaint seeking an injunction to prevent the IRS from examining papers of the taxpapers' bankers and brokers with respect to the taxpayers' financial affairs. The Court refused to be diverted by technicalities. It observed that the consequence of denying the taxpayers the protection of the Fourth Amendment would be "to give to the revenue agents infor-

*Although the Court stated that the bank "waived any right it might have had to resist production" (R. 140), the bank has not responded to the summons and did not appear in this action or contest petitioners' right to the requested relief.

mation of the private affairs of the taxpayers and, by indirection, give the government a searching power of the defendants' affairs which it cannot legally assert against the taxpayers themselves" (81 F. 2d at 849). The Court further stated:

> "We are not impressed with the contention that the granting of the injunction prayed for will cripple the hands of the taxing authorities. . . . Nor are we moved by the contention that the action of the taxpayers' bankers and brokers, in the way of submitting the affairs of the taxpayers to an unreasonable search, can deprive this man and his wife of their constitutional protection against unreasonable search. It is Zimmermann and his wife, and not their bankers and brokers, who are the real and aggrieved parties before us. To say that their bank accounts, withdrawals, their loans and collateral deposits, are the property of their bankers and brokers, and the taxpayers have no right or standing to prevent an unreasonable search thereof, is to lose sight of substance and rest on shadow" (*Id.* at 848).

Finally, the Court ruled:

> "It is the right of the taxpayers . . . that is here involved. It is the information the bankers' books contain, and not the books in which that information is recorded, that is the property right of these taxpayers, a property right this Court protects by injunctive relief" (*Id.* at 849).

The Circuit Court below noted the *Zimmermann* holding but stated that it was modified by the Third Circuit's later opinion in the same case reported at 105 F. 2d 583 (1939) (R. 140 n. 11). However, the matter relied upon by the Court below as constituting the modification was mere dictum (*Id.* at 586). The second opinion in *Zimmermann* involved an appeal by the taxpayer after the Government

had answered the complaint and made a showing which, the Court found, established reasonable grounds to believe that there was fraud. The District Court herein properly analyzed these cases when it stated:

> "The first Zimmerman vs. Wilson case, supra, establishes that the information contained in the third parties' books concerning the taxpayer is a 'property right of the taxpayer' that the Court will protect, and this concept is not disturbed by the decisions in the subsequent hearings on the same cause, although the holding of the initial case is weakened by the later decisions and the dicta contained therein" (R. 38-39; App. D, p. 23a).

See also, Note, 60 Mich. L. Rev. 781, 791 (1962).

The sufficiency of petitioners' interest in the bank's records is also supported by *Brex* v. *Smith*, 146 Atl. 34 (N. J. Ch. 1929). There, in granting the depositor an injunction to prevent a bank's disclosure of information in its records concerning transactions by and with the depositor, the Court stated:

> "It may be that the relation of a bank to its depositors is that of debtor and creditor, but I think it is more than that. As far as the money actually deposited is concerned, that is true. But, as to the records of the accounts, the deposits and withdrawals, that is another matter. There is an implied obligation, as I see it, on the bank, to keep these from scrutiny until compelled by a court of competent jurisdiction to do otherwise. *The information contained in the records is certainly a property right*" (146 Atl. at 36) (emphasis added).

And see 73 Banking L. J. 163 (1956); Note, 45 Yale L. Rev. 1523, 1526 (1936).

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted.

JAY H. TOPKIS
Attorney for Petitioners.

New York, N. Y.
May 23, 1963

PAUL, WEISS, RIFKIND, WHARTON & GARRISON
GERALD D. STERN
MORRIS J. GALEN
Of Counsel

APPENDIX A

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

PERRY A. DEMASTERS, et al., *Appellants,* v. EGON D. AREND and MELA K. AREND, *Appellees.*	No. 17,796

APPEAL from the United States District Court for the District of Oregon.

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the District of Oregon and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is reversed.

Filed and entered January 24, 1963.

APPENDIX B

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

PERRY A. DEMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON), *Appellants,* vs. EGON D. AREND and MELA K. AREND, *Appellees.*	No. 17,796 Jan. 24, 1963

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON

Before: MERRILL, BROWNING and DUNIWAY, Circuit Judges

BROWNING, Circuit Judge:

The District Court permanently enjoined appellants (employees of the Internal Revenue Service) from investigating possible income tax liability of appellee taxpayers for years as to which recovery would be barred by the statute of limitations in the absence of fraud. The Court also permanently enjoined the United States National Bank of Portland from disclosing to appellants any information

regarding transactions by or with the taxpayers during such years. We reject appellants' contention that a District Court has no power to issue such a restraining order in any circumstances, but we conclude that the Court lacked power to do so in the circumstances of this case.

The taxpayers'[1] 1946 and 1948 income tax returns were audited and their records for those years examined during 1948 and 1950. In 1957 appellant De Masters, an Internal Revenue agent, began a new investigation of the taxpayers' returns. It is stipulated that the period during which additional income tax could be assessed against taxpayers for any year prior to 1955 had expired, unless fraud were involved.[2] The taxpayers furnished De Masters with the information which he requested until he sought access to taxpayers' records without limitation as to date. Appellees' counsel then advised De Masters that in view of the prior audits and because the taxpayers were not charged with fraud they would not cooperate further in the investigation.

De Masters prepared tentative computations from various sources which indicated that the increase in the taxpayers' net worth, plus their estimated living expenses, during the period 1940 through 1956 totaled approximately $170,000. This increase, after appropriate adjustments, exceeded the income which the taxpayers reported during the same period for tax purposes by more than $90,000. He then examined records of a branch of the First National Bank of Portland reflecting deposits during 1948 to the account of taxpayers' shoe store, and found that they totaled

---

[1]The taxpayers are husband and wife.

[2]If a false or fraudulent return with intent to evade the tax, or a willful attempt in any manner to defeat or evade tax, is involved, the tax may be assessed at any time. 26 U. S. C. A. §6501 (c)(1) and (2).

some $17,000 more than the gross receipts reported on taxpayers' income tax return for that year.

De Masters concluded that further investigation was justified, and caused a summons to issue directing the United States National Bank of Portland to produce records pertaining to the taxpayers' transactions with the bank during the years 1940 to 1957. The taxpayers were advised that the bank would comply with the summons. They then filed the present suit for an injunction, naming the bank, the Commissioner of Internal Revenue, the District Director, and De Masters as defendants.

The District Court held a hearing at which De Masters testified as to his computations and the results of his analysis of the taxpayers' 1948 deposits with the First National Bank of Portland. The Court concluded that the appellants had "failed to establish by competent evidence that there exists any reasonable grounds or other probable cause to find or suspect that any fraud existed with respect to any of the returns filed by the plaintiffs for the years that are now closed by the statute of limitations," and that the taxpayers were therefore entitled to an injunction. The Court permanently enjoined the appellants from examining the taxpayers or their records, or any third party as to transactions with the taxpayers, with respect to any year prior to 1955; and permanently enjoined the United States National Bank of Portland from disclosing any information as to transactions with the taxpayers prior to that year.

Appellants contend that (1) the District Court lacked jurisdiction of the action, (2) the suit was one against the United States to which consent had not been given and was therefore barred by the doctrine of sovereign immunity, and (3) the District Court's decision on the merits was erroneous.

Appendix B

I

The taxpayers assert that their suit falls in the category of actions "arising under any Act of Congress providing for internal revenue" over which district courts are granted original jurisdiction by Section 1340 of the Judicial Code.[3] Concededly, appellants purported to act under the authority of Section 7602 of the Internal Revenue Code[4] in issuing the summons to the bank. The taxpayers challenged appellants' authority under that section on the ground that the inquiry was prohibted by Section 7605 (b) of the Internal Revenue Code[5] as well as by the Fourth Amendment. Since the taxpayers' suit involved a substantial controversy as to the construction and effect of these sections of the Code, we agree with the District Court that if otherwise maintainable, the action fell within the jurisdictional grant of Section 1340.[6]

---

[3] "The District Courts shall have original jurisdiction of any civil action arising under any Act of Congress providing for internal revenue." 28 U. S. C. A. § 1340.

[4] "For the purpose of . . . determining the liability of any person for any internal revenue tax . . . the Secretary or his delegate is authorized— . . . .

(2) To summon . . . any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax . . . to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data . . . as may be relevant or material to such inquiry . . . ." Int. Rev. Code of 1954, § 7602. 26 U. S. C. A. § 7602.

[5] "No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary." Int. Rev. Code of 1954, § 7605 (b). 26 U. S. C. A. § 7605 (b).

[6] See United States v. Coson, 286 F. 2d 453, 456 (9th Cir. 1961).

Appendix B

II

Section 1340 is not a consent by the United States to suits against it.[7] However, if appellants were indeed prohibited by Section 7605(b) or the Fourth Amendment from initiating this inquiry, a suit to restrain their unlawful conduct would not be barred by the doctrine of sovereign immunity.[8]

A. *The Fourth Amendment*

Appellants' conduct did not violate the Fourth Amendment. They did not seek to compel production of the taxpayers' books and records, and if they had the Fourth Amendment would offer no basis for resisting that demand.[9] Assuming that an administrative subpoena directed to a corporation may constitute an "unreasonable search and

---

[7]United States v. Coson, 286 F. 2d 453, 456 (9th Cir. 1961); First Nat'l Bank v. United States, 265 F. 2d 297, 299 (3d Cir. 1959). Compare Application of Colton, 291 F. 2d 487, 489-90 (2d Cir. 1961), 75 Harv. L. Rev. 1222 (1962).

[8]Malone v. Bowdoin, 369 U. S. 643, 647-48 (1962); Larson v. Domestic & Foreign Corp., 337 U. S. 682, 689-90 (1949), and cases cited; California v. Rank, 293 F. 2d 340, 349-53 (9th Cir. 1961), cert. granted 370 U. S. 936 (1962). See Harmon v. Brucker, 355 U. S. 579, 581-82 (1958); Stark v. Wickard, 321 U. S. 288 (1944); Colorado v. Toll, 268 U. S. 228, 230 (1925). See also Leedom v. Kyne, 358 U. S. 184, 190 (1958); Application of Colton, 291 F. 2d 487, 489-90 (2d Cir. 1961), and cases cited, 75 Harv. L. Rev. 1222 (1962). See generally 75 Harv. L. Rev. 1479, 1479-93 (1962). We are also satisfied that this taxpayers' suit is neither one for declaratory judgment "with respect to federal taxes" precluded by 28 U. S. C. A. § 2201; nor an action "for the purpose of restraining the assessment or collection of any tax" precluded by 26 U. S. C. A. § 7421 (a).

[9]See National Plate & Window Glass Co. v. United States, 254 F. 2d 92 (2d Cir. 1958); Bolich v. Rubel, 67 F. 2d 894 (2d Cir. 1933).

seizure,"[10] the right violated would be that of the bank whose papers were demanded; but the bank waived any right it might have had to resist production, and the taxpayers could not in any event assert the right on the bank's behalf.[11]

B. *Section 7605(b)*

Section 7605(b) contains two distinct prohibitions: The first is that "no taxpayer shall be subjected to unnecessary examination or investigations"; the second that "only one inspection of a taxpayers' books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investi-

[10]Some doubt is suggested by Oklahoma Press Publishing Co. v. Walling, 327 U. S. 186, 195 (1946), and First Nat'l Bank v. United States, 295 Fed. 142 (S. D. Ala. 1924); aff'd 267 U. S. 576 (1925). See also 69 Yale L. J. 131, 132-33 (1959).

[11]Foster v. United States, 265 F. 2d 183, 187-88 (2d Cir. 1959), and cases cited. The taxpayers rely upon Zimmermann v. Wilson, 81 F. 2d 847 (3d Cir. 1936), but the Court of Appeals for the Third Circuit modified its decision upon this point in a later opinion in the same case reported at 105 F. 2d 583, 586 (1939), stating, "our present view that a third party is not entitled to invoke the protection of the Fourth Amendment brings our decision in line with the overwhelming weight of authority." See 43 Va. L. Rev. 114 (1957). See also Baskerville v. United States, 227 F. 2d 454, 456 (10th Cir. 1955); United States v. Eversole, 209 F. 2d 766, 768 (7th Cir. 1954). See also United States v. White, 322 U. S. 694, 699 (1944), and cases cited; Tileston v. Ullman, 318 U. S. 44 (1943). Fourth Amendment rights do not depend upon nice distinctions of property law (cf. Silverman v. United States, 365 U. S. 505, 511 (1961), and cases cited), but the taxpayers had no interest in the bank's records of the kind the Fourth Amendment was intended to protect. Their interest was no different nor greater than that which they would have in denying appellants access to documentary evidence belonging to, in the possession of, and to be produced by, any third person, which might contain information damaging to the taxpayers. Cf. Jones v. United States, 362 U. S. 257, 261 (1960).

gation, notifies the taxpayer in writing that an additional inspection is necessary."

1. Appellants neither violated the second prohibition nor, at the time of suit, threatened to do so.

This prohibition applies by its express terms only to the *taxpayers'* records; it did not prevent the appellants from seeking information from other sources, such as the bank, regarding the taxpayers' possible liability.[12] Indeed, the section anticipates that such inquiries will be made; as we read it, the section intends that the Commissioner of Internal Revenue (the Secretary's delegate) shall notify the taxpayer of an additional inspection of the taxpayer's books only "after investigation" from which the Commissioner concludes that "an additional inspection is necessary," and the preliminary investigation referred to must necessarily be an inquiry of sources other than the taxpayer.

There is nothing to indicate that appellants intended to seek a second inspection of the taxpayers' records for the years 1946 and 1948 unless, and until, the investigation of other sources required by Section 7605 (b) had been completed, and had disclosed that an additional inspection of taxpayers' records was necessary. De Masters testified that the reason the taxpayers had not been notified of a second examination of their own records was that he had not completed the preliminary investigation required to sustain the notice. The threat that appellants would attempt a second examination of taxpayers' records without first satisfying the prerequisites of Section 7605(b) was at best remote and speculative.[13]

---

[12]Application of Magnus, 299 F.2d 335 (2d Cir. 1962); Foster v. United States, 265 F.2d 183, 188 n. 3 (2d Cir. 1959); Hubner v. Tucker, 245 F.2d 35, 39 (9th Cir. 1957).

[13]See Eccles v. Peoples Bank, 333 U. S. 426, 431 (1948).

2. We turn finally to the provision of Section 7605(b) that "no taxpayer shall be subjected to unnecessary examinations or investigations."

The command is unequivocal. We have held that it constitutes "a limitation on the power" of the tax collecting authorities; appellants, in consequence, had "no power to make an unnecessary examination or investigtaion."[14] As we have said, if appellants violated this statutory limitation upon their power, the present suit is maintainable.[15] The difficult problem, of course, is that of determining the scope of the limitation: what is meant by an "unnecessary" investigation.

The Commissioner's statutory duty and power to inquire are stated in broad terms. He is directed to "cause officers or employees of the Treasury Department to pro-

---

[14]Martin v. Chandis Securities Co., 128 F. 2d 731, 735-36 (9th Cir. 1942). We have been invited to re-examine *Chandis* in the light of Application of Magnus, 289 F. 2d 335, 337 (1962), in which the Court of Appeals for the Second Circuit recently held that the prohibition in Section 7605 (b) against unnecessary investigations (as well as that against repeated inspections of taxpayer's books and records) applies only to inquiries made of the taxpayer personally, and does not extend to inquiries made of third persons even though concededly part of an investigation directed solely to the taxpayer's liability. As the Court in *Magnus* points out, inquiries of third parties impose no burden upon the taxpayers, the third parties may have judicial protection from unwarranted and unreasonable search and seizure independently of Section 7605(b), and the government would not be barred from making inquiries which might throw light on the taxpayer's liability and enable the government to demonstrate that a direct examination of the taxpayer and his records is necessary. See also Foster v. United States, 265 F. 2d 183, 188 n. 3 (2d Cir. 1959). But see Colton v. United States, 306 F. 2d 633, 635-36 (2d Cir. 1962), petition for cert. filed, 31 U. S. L. Week 3173 (U. S. Oct. 26, 1962) (No. 560). However, the disposition which we make of the present case renders a re-examination of *Chandis* unnecessary.

[15]See note 8, supra.

ceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax."[16] He is authorized to examine records and data and to require persons liable for tax and others to appear, give testimony, and produce records and data, relevant or material to an inquiry "for the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax . . . or collecting any such liability."[17]

These grants of power are to be liberally construed in recognition of the vital public purposes which they serve;[18] the exception stated in Section 7605(b) is not to be read so broadly as to defeat them.[19] A limited construction of Section 7605(b) is also supported by the law's general antipathy to the erection of barriers to the ascertainment of truth,[20] and the policy against judicial intervention in the investigative stage of tax matters because of the danger of undue delay in the collection of the revenues.[21]

An investigation cannot be said to be "unnecessary" if it may contribute to the accomplishment of any of the purposes for which the Commissioner is authorized by statute to make inquiry. Since these include making a return where none has been made and ascertaining the correctness of any

---

[16]Int. Rev. Code of 1954, § 7601; 26 U. S. C. A. § 7601.

[17]Int. Rev. Code of 1954, § 7602, 26 U. S. C. A. § 7602.

[18]Falsone v. United States, 205 F. 2d 734, 742 (5th Cir. 1953).

[19]Application of United States, 246 F. 2d 762, 765 (2d Cir. 1957).

[20]Application of Magnus, 299 F. 2d 335, 337 (2d Cir. 1962); McMann v. SEC, 87 F. 2d 377 (2d Cir. 1937).

[21]See Ettochs v. Williams Packing Co., 370 U. S. 1, 7 (1962); N. Y. U. 18th Annual Institute on Federal Taxation 958 (1960).

that have, the taxpayer[22] will rarely be able to discharge his burden of showing that the first investigation of a particular tax year is unnecessary. The legislative history, though sparse, tends to confirm the impression that Congress was primarily concerned with protecting taxpayers from examinations which were "unnecessary" in the sense that they followed prior investigations of the same matter which had established that there was no basis for liability.[23]

---

[22]Perhaps a third person might show that an investigation was unnecessary as to him because he had no material relating to the taxpayer's liability, but here the issue is more likely to arise in resisting enforcement of a summons and the ground for relief more likely to be stated in terms of the burdensomeness of the demand. See United States ex rel. Sathre v. Third Northwestern Nat'l Bank, 102 F. Supp. 879 (D. Minn. 1952); Foster v. United States, 265 F. 2d 183, 187 n. 2 (2d Cir. 1959); 60 Mich. L. Rev. 187, 204-05 (1961).

[23]It may also be drawn from the remarks of sponsors of the provision that Congress anticipated that its purpose of ending such "frivolous" investigations would be accomplished primarily through administrative control resulting from the requirement that the Secretary notify the taxpayer in writing of the necessity for repeating the inquiry—although it should be added that there is nothing to indicate an intention to exclude judicial intervention if administrative control should fail. What is now Section 7605 (b) of Title 26 first appeared as Section 1308 of the Revenue Bill of 1921. In presenting the proposal to the House, Congressman Hawley, in charge of the measure, stated (61 Cong. Rec. 5202 (1921)):

> "We had instances before us where the books of a corporation or an individual had been examined four or five times, with four or five different assessments of taxation. There ought to be one levy of tax, one determination of it. It ought to be settled once for all when a man pays his tax, unless there should be good cause for a re-examination.
>
> Of course the Commissioner would not cause a frivolous examination to be made or an examination to be made on a frivolous ground."

Similarly, Senator Penrose, in charge of the measure, advised the Senate (61 Cong. Rec. 5855 (1921)):

> "[B]itter complaints have reached me and have reached the department of unnecessary visits and inquisitions after a

Appendix B

As the Court of Appeals for the Second Circuit has said, "The stricture against 'unnecessary' examinations was designed to prevent uselessly repetitive procedures and investigations not relevant to possible tax liability, not to nullify the preceding sections of the Code."[24]

The investigative power granted administrative agencies is inquisitorial in nature; its exercise does not depend upon a showing of probable cause to believe that a violation of law has occurred.[25] This is true of the power of inquiry vested in the Commissioner.[26] Clearly, he may as a general rule check to determine whether a return should have been filed where one was not, or whether more tax was due than was actually paid, without first showing that there was probable cause, or any cause at all, to believe that these things were true. The Bureau of Internal Revenue, like other administrative agencies charged with enforcement of

---

thorough examination is supposed to have been had. This section is purely in the interest of quieting all this trouble and in the interest of the peace of mind of the honest taxpayer."

In the same passage, Senator Penrose agreed with the statement of Senator Walsh that the purpose of the Section as "to limit the inspection to one visit unless the Commissioner indicates that there is necessity for further examination."

The report of the Senate Committee (S. Rep. No. 275, 67th Cong., 1st Sess. 31 (1921)) states that the provision is designed to meet the complaint of taxpayers that they are subjected to onerous and unnecessarily frequent examinations and investigations by revenue agents." H. R. Rep. No. 337, 67th Cong., 1st Sess. 16 (1921), is to the same effect.

[24]Application of the United States, 246 F. 2d 762, 765 (1957); 60 Mich. L. Rev. 187, 204-05 (1961).

[25]United States v. Morton Salt Co., 338 U. S. 632, 642-43 (1950); Oklahoma Press Publishing Co. v. Walling, 327 U. S. 186, 214-16 (1946); Endicott Johnson Corp. v. Perkins, 317 U. S. 501 (1943); Hagen v. Porter, 156 F. 2d 362, 365 (9th Cir. 1946); 69 Yale L. J. 131, 133 (1959); 1 Davis, Administrative Law, § 3.12 (1958).

[26]Foster v. United States, 265 F. 2d 183, 186 (2d Cir. 1959), and cases cited.

law, "can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not."[27]

But the taxpayers assert that Section 7605(b) creates an exception to this rule where the Commissioner seeks to investigate a return for a tax year as to which, unless fraud is shown, the statute of limitations has barred additional assessment.[28] It is not apparent why this should be so.

---

[27] United States v. Morton Salt Co., 338 U. S. 632, 642-43 (1950).

[28] The decisions of the Courts of Appeals establish no clear rule as to whether an additional showing is required of the government in these circumstances to obtain enforcement of a subpoena issued under Section 7602, and, if so, what that showing must be. *First:* The Court of Appeals for the First Circuit has most nearly approached a requirement that "probable cause" in the Fourth Amendment sense be shown (O'Connor v. O'Connell, 253 F. 2d 365, 369-70 (1958); Lash v. Nighosian, 273 F. 2d 185, 188-89 (1959)), and in so doing expressly disagrees with holdings of Courts of Appeals for the Second and Fifth Circuits (253 F. 2d at 370). However, the Court views the issue as one of fact as to which the Commissioner's determination is binding if supported "by witnesses whose testimony, although contradicted, was not so incredible as to be beyond belief" (273 F. 2d at 189). *Second:* The Court of Appeals for the Second Circuit appeared to adopt the rule that no showing need be made as to possible fraud: "Nor should [the Bureau] be required to prove the grounds of its belief prior to examination of the only records which provide the ultimate proof" (United States v. United Distillers Prods. Corp., 156 F. 2d 872, 874 (1946)); "The Commissioner is therefore entitled to the examination if it may shed light on whether a liability still exists or whether it has been time-barred. . . . the Commissioner . . . should not be required to prove grounds for belief that the liability was not time-barred" (Foster v. United States, 265 F. 2d 183, 187 (1959)). But the Court nonetheless treated the question as still open in Application of United States, 246 F. 2d 762, 765 (1957), and again in Application of Magnus, 299 F. 2d 335, 337 (1962). *Fourth:* The Court of Appeals for the Fourth Circuit noted the difference in view among the Courts of Appeals and found it unnecessary to resolve it; but took it to be admitted that "a bona fide suspicion of fraud justifies the investigation of the appropriate records." Wall v. Mitchell, 287 F. 2d 31 (1961). *Fifth:* The Court

Appendix B

The Commissioner's power and duty to investigate for the purpose of "determining the liability of any person for any internal revenue tax"[29] surely includes liability which may be assessed on a finding of fraud. And even if no fraud exists, the investigation of barred years may be useful or even essential to establish a sound starting point for checking the accuracy of returns filed in years that remain

---

of Appeals for the Fifth Circuit is usually cited as requiring no showing of facts justifying a suspicion of fraud on the basis of its cryptic opinion in Globe Constr. Co. v. Humphrey, 229 F. 2d 148 (1956). See, e.g., O'Connor v. O'Connell, supra, 253 F. 2d at 370. *Sixth:* The Sixth Circuit has held that an agent's testimony that he had concluded from his investigation that there was a strong suspicion of fraud was sufficient, and that "the special agent was not obliged to disclose in detail the facts relative to his investigation and conclusion, nor was the District Court obliged to require proof of facts showing reasonable grounds to believe that the tax returns . . . were false or fraudulent." Peoples Deposit Bank & Trust Co. v. United States, 212 F. 2d 86, 87 (1954). In Corbin Deposit Bank v. United States, 244 F. 2d 177 (1957), the Court said, "probable cause . . . was established by the testimony of an internal revenue agent who enumerated facts showing reasonable grounds for a suspicion of fraud," and the District Court properly excluded "evidence for the purpose of proving that the taxpayers in fact had filed honest returns." Finally, in Eberhart v. Broadrock Dev. Corp., 296 F. 2d 685, 687 (1961), the Court stated, "there was at least an inference that fraud extended into some of the previous years. In our judgment, this was sufficient to authorize the examinations." *Ninth:* The Court of Appeals for the Ninth Circuit in Martin v. Chandis Securities Co., 128 F. 2d 731, 735 (1942), acted upon an agreement of the parties that a showing was required "of probable cause, sometimes called reasonable ground for suspicion of fraud," but "without expressing any opinion as to the soundness thereof." In Boren v. Tucker, 239 F. 2d 767 (1956), we found the test assumed in *Chandis* to be satisfied by proof of a "possibility" of fraud, and expressed approval of *Globe*, supra, 229 F. 2d 148 (5th Cir.), and *Peoples Deposit*, supra, 212 F. 2d 86 (6th Cir.), both of which, as noted above, require no showing as to the likelihood of fraud. 239 F. 2d at 769-70, 773.

[29] Int. Rev. Code of 1954, § 7602, 26 U. S. C. A. § 7602.

open.[30] If a preliminary showing of probable cause is not necessary before initiating investigations for other authorized purposes, how can it be required for these?

The taxpayers suggest two reasons: a policy against the presumption of fraud; and a policy in favor of preserving the integrity of the statute of limitations. But it is not necessary to presume fraud to justify an investigation to determine whether it exists. The Commissioner's power to investigate particular returns for normal errors or omissions is not based upon a presumption that they will be found. And while the policy in favor of composing strife, reflected in the statute of limitations, is entitled to protection, so too is the Congressional policy that fraud affecting the revenue shall be exposed and penalized without regard to the elapse of time, especially in a tax system so largely based on self-assessment.

We think the limitations imposed upon the Commissioner by the interdiction of "unnecessary" investigations are essentially the same as those which may preclude judicial enforcement of administrative subpoenas: "that he shall not act arbitrarily or in excess of his statutory authority, but this does not mean that his inquiry must be 'limited . . . by . . . forecasts of the probable result of the investigation' "[31] These limitations are appropriate "to secure the

---

[30] Falsone v. United States, 205 F. 2d 734, 743 (5th Cir. 1953); Norda Essential Oil & Chem. Co. v. United States, 230 F. 2d 764, 765 (2d Cir. 1956). Appellants do not appear to rely upon this basis for now examining the barred years in the present case, apparently satisfied that the returns filed in the open years were accurate; they do argue, however, that the injunction should at least be modified so as not to preclude such an examination if evidence of deficiencies in the open years were later obtained.

[31] Oklahoma Press Publishing Co. v. Walling, 327 U. S. 186, 216 (1946):

This does not mean that Section 7605 (b) adds nothing to the taxpayers' protection. Section 7605 (b) permits a judicial testing

public interest and at the same time to guard the private ones affected against the only abuses from which protection rightfully may be claimed. . . . They are the interests of men to be free from officious interneddling, whether because irrelevant to any lawful purpose or because unauthorized by law, concerning matters which on proper occasion and within lawfully conferred authority of broad limits are subject to public examination in the public interest. Officious examinations can be expensive . . . time consuming . . . and . . . persecution when carried beyond reason"; but to bar investigation by the Commissioner because evidence of unlawful conduct is not yet available "would stop much if not all of investigation in the public interest at the threshold of inquiry and . . . render substantially impossible his effective discharge of the duties of investigation and enforcement which Congress has placed upon him."[32]

Of course, proof that the period for assessment absent fraud has expired is relevant to the question of whether an investigation is "unnecessary," just as it would be relevant to whether a court should enforce an administrative subpoena.

The purposes for which the Commissioner is authorized to investigate would then be limited. If he asserted no purpose other than one which was then barred of accomplishment (or asserted a purpose not authorized by the statute).[33]

---

of the basic legality of the administrative action at an earlier stage than might otherwise be possible, and it provides a novel check on repetitious investigations which, as we have seen (note 23), was apparently its principal purpose.

We are not here concerned with limitations based upon the breadth of the inquiry or the relevance to the inquiry of the material sought. 1 Davis, Administrative Law § 3.05 (1958).

[32] 327 U. S. at 213.

[33] See Pacific Mills v. Kenefick, 99 F. 2d 188 (1st Cir. 1938).

the proposed investigation would be "unnecessary" under Section 7605 (b) and might be enjoined, just as an administrative subpoena issued by the Commissioner in such circumstances would be denied judicial enforcement as "in excess of his statutory authority."

Even though the Commissioner asserted a purpose to investigate for fraud, or to confirm a deficiency in an open year, as he was authorized to do, the likelihood that the inquiry might be "unnecessary" or the issuance of a subpoena "arbitrary," would at least be enhanced by the relative infrequency with which either fraud, or the need for indirect verification of a deficiency normally occurs. And if it appeared that the decision to investigate in aid of that purpose was in fact reached as a matter of rational judgment based on the circumstances of the particular case, then the investigation would not be an "unnecessary" one prohibited by Section 7605 (b), just as the act of issuing an administrative subpoena in such circumstances would not be "arbitrary" and the subpoena unenforceable.

This limited extension of the area of proper judicial intervention in the process of administrative investigation is justified by a significant change in the relevant balance of public and private interests which takes place with the running of the statute of limitations. The government's need for speedy and unimpeded access to the facts is diminished when the problem shifts from that of checking the accuracy of the returns of sixty million taxpayers within the relatively short period of limitations, to that of ferreting out the rare instance of liability for fraud which can never be barred by the passage of time. From the taxpayer's point of view, an inquiry which can be readily met when memories are clear and records readily available, may be-

come difficult to satisfy with a lapse of time, possibly extending, as in this case, to a score or more of years.

The showing by the taxpayers in the present case that further assessment was time-barred in the absence of fraud may have been sufficient to require the appellants to go forward with a justification of their inquiry. But this they did, and the showing which they made was sufficient to establish (1) that further investigation was undertaken pursuant to the Commissioner's authority, and (2) that the decision to proceed was not arbitrary. No more was required.

Reversed.

(Endorsed) Opinion Filed Jan. 24, 1963.

Frank H. Schmid, Clerk.

APPENDIX C

Memorandum Opinion of the District Court

East, J.

It appears from the evidence that the defendant officials of the Internal Revenue Service seek the plaintiffs' tax returns and tax liability for the years 1941 through 1950 and have issued a summons upon the United States National Bank of Portland (Oregon), directing it to furnish to the defendant Perry A. DeMasters in the matter of the alleged tax liability of the plaintiffs for the calendar years of 1940 to 1957, all records pertaining to the deposit, withdrawal and transfer of funds in all savings and commercial accounts and all records pertaining to the financial, loan and investment activities of the plaintiffs and each of them, and plaintiffs' children, Richard and Inez Arend, and of Arend Shoe Company, formerly a sole proprietorship owned by Egon D. Arend.

It further appears that the statute of limitations has run against the Commissioner to assess additional income taxes against the plaintiffs for the calendar year 1954 and all prior years.

It does not appear to the Court from the evidence that the defendant Perry A. DeMasters, immediately prior to the issuance of said summons, had any reasonable grounds or other probable cause to find or suspect that any fraud existed with respect to any of the returns filed by the plaintiffs for the years that are now closed by the statute of limitations, and the Court concludes that the relief prayed for by the plaintiffs should be granted as to such years.

Dated October 11, 1961

[Endorsed]: Filed October 11, 1961.

APPENDIX D

Opinion of the District Court Denying Respondents' Summary Judgment Motion

The plaintiff taxpayers were investigated by the agents of the Internal Revenue Commissioner (Commissioner) and cleared as to certain years in question. Now, after the statute of limitations has run as to years 1940 through 1955, the Commissioner is attempting to again investigate the same. On August 14, 1958, the Commissioner caused a summons to be served upon the defendant The United States National Bank of Portland (Oregon) (Bank), directing the Bank to furnish to the defendant DeMasters for his use in such investigation all of the records pertaining to the deposits, withdrawal, and transfer of funds in all savings and commercial accounts and all records pertaining to the financial, loan, and investment activity of plaintiffs and each of them, of plaintiffs' children, Richard and Inez Arend, and of Arend Shoe Company, a sole proprietorship owned by plaintiff Egon D. Arend. The taxpayers are advised that the Bank feels itself obliged to comply with this summons.

The taxpayers brought this action to have the Commissioner and his agents enjoined from further prosecution of the investigation, the said summons quashed, and said Bank in turn prevented from surrendering or otherwise granting access to the summonsed records to the Commissioner or his agents.

The Commissioner and his agents ask for a summary judgment pursuant to Rule 56(b) of the Federal Rules of Civil Procedure.

That the summary judgment is not to issue if there is the slightest doubt of an issue or question of fact to be determined is elemental law and need not be here supported by the many cases which determined this point. See 6 Moore's Federal Practice, § 56.15.

Appendix D

In the instant case the taxpayers allege violation of their constitutional rights under the Fourth Amendment of the Constitution of the United States, and that, therefore, the defendants are acting in excess of the authority granted to such agents by 26 U. S. C. A. § 7602, as restricted by 26 U. S. C. A. § 7605(b). And, further, that the years in question are outside the limitations set by the statute for reassessment of taxes.

Taxpayers contend that 26 U. S. C. A., § 7605(b), providing:

> "Restrictions on examinaiton of taxpayer.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary."——

prevents the defendants from re-examining the papers or transactions of the plaintiffs during this period. Further, that the requirements of § 7605(b) were not met in notifying taxpayers that these years were to be audited again.

As pointed out, the years in question are outside the period of limitations against a reassessment of taxes. In an attempt to fall within an exception of the statute of limitations, the affidavit of the defendant DeMasters raises an apparent contention and imparts to the taxpayers fraud on their part against the Government in connection with the preparation and filing of their tax returns for the years in question. The taxpayers in turn refute this contention and intimate, if not assert, that the requested inspection of the Bank's records is arbitrary and a harrassment to the taxpayers, bringing absolutely unnecessary and extreme hardship.

Thus, it clearly appears that issues and questions of fact are raised in this controversy.

The only issue of law on which the case could be settled, without determination of the factual situation and issues raised, would be whether or not the Court has the jurisdiction to enjoin the Commissioner and his agents to prevent certain conduct on their part which is arbitrary or in excess of their authority, or whether or not the Code itself prevents such investigation.

Although the Courts are hesitant to interfere with other branches of the Government, still it is hornbook law that the courts can prevent unconstitutional and arbitrary harrassment of citizens by agents of the administrative agencies, or prevent such agents from acting in excess of their authority as established by law, and the agents of the Bureau of Internal Revenue are no exception. See 28 Am. Jur., Injunctions, §§ 176-181.

Title 28 U. S. C. A. § 1340 provides:

"The district courts shall have original jurisdiction of any civil action arising under any Act of Congress providing for internal revenue, or revenue from imports or tonnage except matters within the jurisdiction of the Customs Court."

Although most of the cases which come before the courts are those wherein there is a refusal to comply with a summons to produce records, either the taxpayers or a third party who has records concerning the taxpayer's business, still there is nothing to prevent the taxpayer from taking the initiative and preventing the Commissioner from investigating, especially when the third party notifies the taxpayer that it will comply with the order issued by the defendants to produce records concerning the taxpayer's banking business. The situation does arise by reason of the

use of the revenue statute on the part of the defendants, and, hence, this is a "* * * civil action arising under * * * [an] Act of Congress providing for internal revenue * * *" and as such is within the jurisdiction of the Court.

The question of granting an injunction in the instant case is unusual, but it is not entirely novel, as it was raised in Zimmerman, et al., vs. Wilson, et al., 81 F. 2d 847 (CCA 3 1936), and in none of the subsequent proceedings of that cause, 25 F. Supp. 75 (DC ED Penn. 1938) and 105 F. 2d 583 (CCA 3 1939), was the decision based upon the determination that the injunction could not issue because the Court was without jurisdiction to give such relief to prevent the search of the third party's books.

The first Zimmerman vs. Wilson case, supra, establishes that the information contained in the third party's books concerning the taxpayer is a "property right of the taxpayer" that the Court will protect, and this concept is not disturbed by the decisions in the subsequent hearings on the same cause, although the holding of the initial case is weakened by the later decisions and the dicta contained therein.

The better-reasoned cases require that the Commissioner show that there is some reasonable suspicion or probable cause to believe fraud exists prior to the court directing compliance with a summons issued by the Commissioner or his agents, or to show that there is some justifiable reason for such investigation when there has been an audit and adjustment already. Martin vs. Chandis Securities Co., 128 F. 2d 731 (CCA 9 1942); O'Connor vs. O'Connell, 253 F. 2d 365 (CA 1 1958); First National Bank of Mobile, et al. vs. U. S., 160 F. 2d 532 (CCA 5 1947); Corbin Deposit Bank of Corbin vs. U. S., 244 F. 2d 177 (CA 6 1957).

Appendix D

The case cited by the defendants, Hubner vs. Tucker, 245 F. 2d 35 (CA 9 1957) does not seem to apply in this situation because there it was a third party whose records concerning the taxpayer under investigation were summonsed who was complaining and would not comply with the summons. The third party did not have any proper interest in the outcome of the investigation, and in that case Judge Fee stated:

"As to the first question, the learned trial judge was correct in holding that § 7605(b) did not apply here. It was held that the 'taxpayer' referred to in that section is the one whose return is under investigation. The showing made by the Special Agent expressly disclaimed any intention of reexamining the papers in reference to any tax liability of Evelyn Hubner. But this very representation of the Internal Revenue Service places her in the category of third persons not connected with the investigation. 'Such persons have rights of their own." 245 F. 2d at pp. 38-39.

In the instant case the situation is one where the complaining party is not the third person but the taxpayer under investigation, hence the section of the Internal Revenue Code appears applicable.

Therefore, from the above, it would seem that an injunction could issue from this Court upon a determination that certain factual conditions did exist. The only proof or indication of fraud on the part of the plaintiffs in the record at the present time is the affidavit of the defendant DeMasters, and this is not sufficient, alone, to show that there is a probable cause to believe that fraud was practiced by the taxpayers. There should be sufficient evidence to show that such a belief is reasonable on the part of the defendants and not just conclusions made by them.

Appendix D

If there is arbitrary action on the part of the defendants, the injunction should issue to protect the plaintiffs from unreasonable and irreparable damage; however, if there is reasonable grounds to suspect fraud on the part of the taxpayers, the defendants should have the opportunity to discover such fraud during the years involved.

It would appear that the defendants' motion for summary judgment should be denied in this instance. Counsel for the taxpayers is requested to submit appropriate order.

Dated January 18, 1960.

/s/ WILLIAM G. EAST,
United States District Judge.

[Endorsed]: Filed January 18, 1960.

APPENDIX E

Opinion of the District Court Denying Petitioners' Summary Judgment Motion

East, J.

This case came on for hearing upon plaintiffs' motion for summary judgment herein against the defendants pursuant to F. R. Civ. P. 56(a)(c).

It appears from the pretrial order subscribed to by counsel for the parties herein on July 30, 1960, that there is a strong reasonable probability that a question or questions of fact remain to be resolved under the defendants' contentions "that there was and is a reasonable basis for the suspicion of fraud" on the part of plaintiffs and, therefore, a summary judgment in favor of plaintiffs is not to issue. See 6 Moore's Federal Practice, § 5615.

Counsel for defendants is requested to file an order substituting Arthur G. Erickson as party defendant in lieu of R. C. Granquist, District Director of Internal Revenue, and a further order denying plaintiffs' motion for summary judgment.

This matter is set for call on Monday, August 7, 1961, for fixing trial date.

Dated this 21st day of July, 1961.

[Endorsed]: Filed July 21, 1961.

LIBRARY
SUPREME COURT, U. S.

Office Supreme Court, U.S.
FILED
JUL 24 1963
JOHN F. DAVIS, CLERK

No. 788

In the Supreme Court of the United States

October Term, 1963

Mary D. Agnew and Alice E. Agnew, petitioners

v.

Peter Dalleo et al., Constituting the Atlantic County Board of Chosen Freeholders, et al.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

ARCHIBALD COX,
Solicitor General,
BURKE MARSHALL,
Assistant Attorney General,
DAVID L. ROSENBLUM,
Attorney,
Department of Justice, Washington 25, D.C.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	3
Argument	5
Conclusion	12

CITATIONS

Cases:

Civil Aeronautics Board v. *Hermann*, 353 U.S. 322 — 9

Colton, Application of, 291 F. 2d 487 — 8

Goldstein v. *United States*, 316 U.S. 114 — 7

Magnus, Application of, 299 F. 2d 335 — 7

Martin v. *Chandis Securities Co.*, 128 F. 2d 731 — 7

Okla. Press Publishing Co. v. *Walling*, 327 U.S. 186 — 9, 11

United States v. *Morton Salt Co.*, 338 U.S. 632 — 9

Constitution and statute:

U.S. Constitution, Fourth Amendment — 6, 7, 11

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 7210 — 8

Sec. 7602 — 2, 9, 11

Sec. 7604 — 8

Sec. 7605 — 3, 5, 6, 7, 8, 9, 10, 11

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 159

EGON D. AREND AND MELA K. AREND, PETITIONERS

v.

PERRY DEMASTERS, INTERNAL REVENUE AGENT, INTERNAL REVENUE SERVICE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions, findings of fact, and conclusions of law of the district court (Pet. 19a–26a; R. 34–41, 43, 53–61) are not reported. The opinion of the court of appeals (Pet. 2a–18a) is reported at 313 F. 2d 79.

JURISDICTION

The judgment of the court of appeals was entered on January 24, 1963 (R. 150),[1] and a petition for rehearing was denied on February 26, 1963 (R. 151). The petition for a writ of certiorari was filed on May 24, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] "R." refers to the Joint Appendix in the court of appeals.

QUESTION PRESENTED

Whether petitioners were entitled to an injunction against any further investigation by the Internal Revenue Service of their tax liability and against compliance by their bank with a Service summons.

STATUTES INVOLVED

Sections 7602 and 7605 of the Internal Revenue Code of 1954 provide in pertinent part:

> SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.
>
> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may

be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

SEC. 7605. TIME AND PLACE OF EXAMINATION.

* * * * * *

(b) *Restrictions on Examination of Taxpayer*—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

STATEMENT

Revenue Agent Perry A. DeMasters began an investigation in 1957 of petitioners' tax returns for the years 1940 through 1956. The investigation revealed that petitioners, upon their arrival in this country from Czechoslovakia in 1940, had a net worth of no more than $10,000 (R. 97); that, although their net worth had increased to approximately $150,000 by the end of 1956 (R. 97), they had reported income of only $43,000 during this period (Gov. Ex. H). Having discovered this unexplained increase in net worth of approximately $100,000, Agent DeMasters sought to determine whether the increase was attributable to unreported income which had been received in those years. An examination of the deposit slips

during 1948 of the Arend Shoe Company [2] account at the First National Bank in Portland, Oregon, revealed that a total of $92,659 had been deposited in 1948 (R. 102). The tax returns filed by petitioners in 1948 reported the gross business sales receipts of the Arend Shoe Company to be $74,968 (R. 102), thus indicating an apparent omission from gross income of over $17,000 for that year. In seeking further proof of unreported income to explain the increase in net worth, the Service issued a summons directed to the United States National Bank of Portland (R. 56). The summons directed the bank to produce for inspection by the Internal Revenue Service all records from 1940 to 1957 pertaining to the financial, loan, and investment activity of petitioners, their children, Richard and Inez Arend, and of the Arend Shoe Company (R. 57).

On August 18, 1958, petitioners instituted the present action to enjoin the Internal Revenue Service from examining any financial records belonging or relating to them for years prior to January 1955 (R. 10). The complaint further prayed that the United States National Bank of Portland be permanently enjoined from disclosing any information regarding transactions by or with petitioners during this same period (R. 10). The complaint alleged *inter alia* that the investigation of petitioner's tax returns for years prior to 1955 was barred, in the absence of fraud, by the statute of limitations; that there was no probable cause to suspect that any fraud existed with respect

[2] The Arend Shoe Company was formerly a sole proprietorship owned by petitioner Egon Arend (R. 57).

to those years; and that further investigation, either of their own records or those of the bank, was therefore precluded by both the Fourth Amendment and by Section 7605(b) of the Internal Revenue Code, *supra*, p. 3, which prohibits "unnecessary" examinations (R. 7–8).

The district court, after hearing the testimony of Agent DeMasters, concluded that the government did not have "reasonable grounds" or other "probable cause" to suspect the existence of fraud, and permanently enjoined the government from examining any records with respect to years prior to 1955 (Pet. 19a; R. 54, 59, 62–63). The court of appeals reversed, holding that the investigation was neither prohibited by the Fourth Amendment nor "unnecessary" within the meaning of Section 7605(b) (Pet. 6a–7a, 18a).

ARGUMENT

The Commissioner of Internal Revenue has commenced an investigation of petitioners' tax liability for the years 1940 through 1956. The investigation, up to this time, has consisted of examining the tax returns filed by petitioners, obtaining records which were voluntarily disclosed by different sources, and issuing a summons to the United States National Bank of Portland to produce its records relating to petitioners. In the absence of a finding of fraud, in which case the tax may be assessed at any time, the statutory period within which to assess additional taxes against petitioners has expired for all years prior to 1955 (R. 47). The Commissioner seeks by his investigation to determine if fraud exists.

Petitioners sought, and the district court issued, an injunction which restrained the Service from examining petitioners, any records of petitioners, or any third party with respect to any year before 1955 (R. 10, 62). The injunction also enjoined the bank from disclosing any information to the Service relating to a year before 1955 (R. 62–63). Petitioners argue that they are entitled to such an injunction under Section 7605(b) of the Code—which prohibits "unnecessary examination or investigations"—and the Fourth Amendment since the Service had insufficient evidence of fraud.

1. Petitioners are plainly not entitled to an injunction against the Service's investigation. A government agency may conduct an investigation, regardless of the amount of evidence it has, as long as it does not use compulsion. It is through such an investigation, which depends on voluntary cooperation with law enforcement authorities, that sufficient evidence is obtained to utilize compulsory process. Thus, the Fourth Amendment, which prohibits only "unreasonable searches and seizures," applies in terms only to certain kinds of government coercion. Section 7605(b) is likewise intended, as the legislative history shows (see *infra*, pp. 8–9), as protection against government harassment.

2. Petitioners are also not entitled to an injunction against the bank's voluntary decision to disclose information to the Service. As we have seen, Section 7605(b) and the Fourth Amendment apply only to compulsory disclosures. Therefore, petitioners' rights

to prevent disclosure by the bank depend exclusively on state law—whether state law prohibits a bank from voluntarily disclosing information relating to its clients to others. Since no such right under Oregon law has been shown, petitioners are not entitled to an injunction against any decision by the bank to cooperate voluntarily.

3. The third issue in this case is whether petitioners are entitled to an injunction against enforcement by the Service of the summons against the bank or compliance by the bank with it. On that issue, petitioners' contentions are also without merit.

a. First, petitioners have no standing to complain under either the Fourth Amendment or Section 7605 (b) concerning a summons which was directed to another party to produce records belonging to that party. It is well established that the Fourth Amendment may be invoked only by the person who is the victim of the search and seizure. *E.g., Goldstein* v. *United States*, 316 U.S. 114. Similarly, Section 7605 (b) is intended to protect against the harassment of repeated inquiries (see *infra*, p. 8). Except for the possible worry that the Service will uncover evidence of fraud, petitioners are in no way affected by a summons directed to their bank. Accord, *Application of Magnus*, 299 F. 2d 335 (C.A. 2).[3]

[3] *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731 (C.A. 9), is not in conflict with *Magnus* since *Martin* involved the resistance of a securities company to a summons directed to it. The company of course had standing since it was directly affected by the summons.

b. Second, Congress has provided a means of challenging an allegedly illegal summons by refusing to obey it and then defending that refusal in a criminal prosecution or enforcement action under Sections 7210 and 7604 of the Code. The government submits that these provisions were intended to be exclusive and that therefore neither an action to enjoin enforcement of the summons nor to quash it may be maintained. While the Second Circuit has suggested the contrary in *Application of Colton*, 291 F. 2d 487, this was on the ground that Section 7210 subjected the recipient of a summons to criminal prosecution for disobedience of it even before the enforcement proceeding.[4] But here the summons was directed to the bank and not to petitioners; consequently, they cannot possibly be subjected to criminal prosecution prior to the enforcement proceeding.

c. Third, on the merits, the court of appeals, after carefully analyzing both the legislative history of Section 7605(b) and the case law interpreting it, held (Pet. 11a–12a):

> * * * Congress was primarily concerned with protecting taxpayers from examinations which were "unnecessary" in the sense that they followed prior investigations of the same matter which had established that there was no basis for liability. As the Court of Appeals for the Second Circuit has said, "The stricture

[4] In *Colton*, the government argued that the motion to quash was barred by sovereign immunity; it did not argue that Sections 7210 and 7604 were exclusive. However, in rejecting the government's contention, the court of appeals discussed these two sections and indicated that they were not exclusive.

> against 'unnecessary' examinations was designed to prevent uselessly repetitive procedures and investigations not relevant to possible tax liability, not to nullify the preceding sections of the Code." *Application of the United States*, 246 F. 2d 762, 765 (1957); 60 Mich. L. Rev. 187, 204–05 (1961).

The court therefore held that the government need establish only that "the decision to investigate * * * was in fact reached as a matter of rational judgment based on the circumstances of the particular case * * *" (Pet. 17a).

This interpretation of the statute is in harmony with the Congressional grant of broad powers to the Commissioner for the purpose of determining a taxpayer's correct tax liability. See Section 7602 of the Internal Revenue Code, *supra*, pp. 2–3. It is also consistent with the doctrine that administrative agencies may "investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." *United States* v. *Morton Salt Co.*, 338 U.S. 632, 642–643. Accord, *Civil Aeronautics Board* v. *Hermann*, 353 U.S. 322; *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 214–216. There is no reason why the Internal Revenue Service should be held to a stricter standard.

Petitioners contend (Pet. 10-14) that the standard applied by the court of appeals under Section 7605(b) is inconsistent with that laid down by other circuits.[5] Whether or not this is true, none of those

[5] The court below appears to consider the rules in other circuits to be unclear (Pet. 13a, note 28).

cases are relevant here. All involved the power of a court to order the taxpayer to comply with a summons issued by the Service. Here, however, the Service merely started an investigation and issued a summons directed to a third party, petitioners' bank. No enforcement proceeding has been started.

Even if, contrary to our arguments above (pp. 7–8), taxpayers may rely on Section 7605(b) when the summons is directed to another party and an action to enjoin the Service from enforcing a summons may be maintained prior to the enforcement proceeding, we submit that the Service, at the least, need only show that it acted rationally in issuing the summons. For the harm to the taxpayers if the summons turns out to be defective is slight if any; they themselves are not harassed even if the summons is ultimately enforced and, furthermore, they can raise their objections in the enforcement proceeding. In short, we believe that, even if the Service must show probable cause to compel enforcement of the summons against its recipient, it need not do so to defend against an injunction action brought by taxpayers who did not receive the summons. No court of appeals has held to the contrary.

The government's evidence in the district court was amply sufficient to meet the test required by the court below under Section 7605(b)—that the decision to issue the summons be based on a rational judgment concerning the circumstances of the particular case. Indeed, we submit that the information of the Service meets the probable cause standard advocated by petitioners. The Service had information that peti-

tioners, upon their arrival in this country in 1940, had a minimal net worth; that as of 1956 their net worth had increased by an amount substantially exceeding the income reported on their returns during this period; and that in the year 1948 alone there was an unexplained omission from gross income of over $17,000 (see the Statement, *supra*, pp. 3–4). While it may well be that the increases in net worth are attributable to non-taxable sources of income, as petitioners contend (Pet. 19–20), it is clear that the Service had probable cause. Whether the accretions can be otherwise explained can be ultimately resolved only after there has been a more thorough investigation which may necessitate use of compulsory process.

The Fourth Amendment, like Section 7605(b), does not require probable cause to issue a summons to produce records. This Court has held that the test to be applied under the Fourth Amendment for a subpoena *duces tecum*, which is essentially the same as a summons to produce documents, is markedly different from the standard applicable to warrants. In *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 209, the Court said that "[t]he requirement of 'probable cause, supported by oath or affirmation,' literally applicable in the case of a warrant, is satisfied in that of an order for production by the court's determination that the investigation is authorized by Congress, is for a purpose Congress can order, and the documents sought are relevant to the inquiry."

Section 7602, *supra*, pp. 2–3, authorized the issuance of a summons to obtain records relevant to an inquiry

into tax liability. The records of petitioners' bank for the tax years being investigated were relevant to the investigation, particularly since the Service had information that petitioners had a large and unexplained increase in net worth during the relevant years. And there can be no doubt that Congress could constitutionally compel a bank to disclose records relevant to a tax investigation.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

JOSEPH M. HOWARD,
NORMAN SEPENUK,
Attorneys.

JULY 1963.

U. S. GOVERNMENT PRINTING OFFICE: 1963

PETITIONERS' REPLY BRIEF

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
AUG 1 1963
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 159

EGON D. AREND and MELA K. AREND,
Petitioners,

v.

PERRY DEMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON),
Respondents.

PETITIONERS' REPLY BRIEF

JAY H. TOPKIS
Attorney for Petitioners
575 Madison Avenue
New York 22, N. Y.

PAUL WEISS RIFKIND WHARTON
& GARRISON

and

GERALD D. STERN
575 Madison Avenue
New York 22, N. Y.

and

MORRIS J. GALEN
Public Service Building
Portland 4, Oregon
Of Counsel

CITATIONS

PAGE

CASES:

Application of Cottoli, 291 F. 2d 487 (2d Cir. 1961) 3

Application of Howard, 210 F. Supp. 301 (W. D. Pa. 1962) 3

McDermott v. John Baumgarth Co., 286 F. 2d 864 (7th Cir., 1961) 3

O'Connor v. O'Connell, 253 F. 2d 365, 369 (1st Cir. 1958) 3

Reisman v. Caplin, 317 F. 2d 123 (D. C. Cir. 1963), *cert. granted*, 31 U. S. L. Week 3416 (June 17, 1963) 2, 3, 4

U. S. Hammam Sifting Corp. v. Eastleman, 170 F. Supp. 12 (N. D. Ill. 1958) 5

Wall v. Mitchell, 287 F. 2d 31 (4th Cir. 1961) 3

Youngstown Sheet & Tube Co. v. Sawyer, 343 U. S. 579 (1952), affirming 103 F. Supp. 569 (D. D. C.) 3

Zimmermann v. Wilson, 105 F. 2d 583 (3d Cir. 1939), affirming 25 F. Supp. 75 (E. D. Pa. 1938) 5

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

EGON D. AREND and MELA K. AREND,
Petitioners,

v.

PERRY DEMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES BANK OF PORTLAND (OREGON),
Respondents.

No. 159

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONERS' REPLY BRIEF

1. The Government's principal argument in opposition to certiorari is that this suit for an injunction to prevent Internal Revenue officials from violating the Constitution (the Fourth Amendment) and a statute (26 U. S. C. § 7605(b)) does not properly lie within the jurisdiction of the District Court (Govt. Br. pp. 7-8). This argument, however, is contrary to the decision of the Court below (R. 138-139). In addition, it presents the same question which

this Court has been asked to decide in *Reisman* v. *Caplin*, 317 F. 2d 123 (D. C. Cir. 1963), *cert. granted*, 31 U. S. L. Week 3416 (June 17, 1963). Indeed, the decision of the Court below in the present case was the key decision relied upon in the *Reisman* petition for certiorari as establishing a conflict among the circuits on this question.

In both Courts below, the Government premised this argument, among other things, on the sovereign immunity doctrine and on the provision in 26 U. S. C. § 7604 concerning enforcement of IRS summonses.

The District Court rejected this contention, stating:

> "Although the Courts are hesitant to interfere with other branches of the Government, still it is hornbook law that the courts can prevent unconstitutional and arbitrary harrassment of citizens by agents of the administrative agencies, or prevent such agents from acting in excess of their authority as established by law, and the agents of the Bureau of Internal Revenue are no exception. See 28 Am. Jur., Injunctions, §§ 170-181." (R. 37).

After quoting 28 U. S. C. § 1340, the District Court added:

> "Although most of the cases which come before the courts are those wherein there is a refusal to comply with a summons to produce records, [by] either the taxpayers or a third party who has records concerning the taxpayer's business, still there is nothing to prevent the taxpayer from taking the initiative and preventing the Commissioner from investigating, especially when the third party notifies the taxpayer that it will comply with the order issued by the defendants to produce records concerning the taxpayer's banking business. The situation does arise by reason of the use of the revenue statute on the part of defendants, and, hence, this is a '* * * civil action arising under * * * [an] Act of Congress

providing for internal revenue * * *' and as such is within the jurisdiction of the Court" (R. 37).

The Court of Appeals agreed with the District Court that "the action fell within the jurisdictional grant of Section 1340" (R. 139). It further ruled:

> "Section 1340 is not a consent by the United States to suits against it. However, if appellants were indeed prohibited by Section 7605(b) or the Fourth Amendment from the initiation of this inquiry, a suit to restrain their unlawful conduct would not be barred by the doctrine of sovereign immunity" (*Ibid.*).

These rulings are well-supported. *E.g., Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U. S. 579 (1952), affirming 103 F. Supp. 569 (D. D. C.).*

The Government's Brief (p. 8) does note that its argument is contrary to the Second Circuit decision in *Application of Colton*, 291 F. 2d 487 (2d Cir. 1961).

Curiously, however, the Government omits to cite the only Court of Appeals decision supporting its argument—namely, that of the Court of Appeals for the District of Columbia Circuit in *Reisman* v. *Caplin*, 317 F. 2d 123 (D. C. Cir. 1963). That decision is soon to be reviewed by this Court pursuant to a writ of certiorari granted on June 17, 1963 (31 U. S. L. Week 3416)—the main argument for certiorari there being that the decision of the District of Columbia Circuit Court of Appeals "is in direct conflict

---

* Recently, the Government made the same unsuccessful argument with respect to a motion to quash an IRS summons: "We rejected the Government's contention that this Court had no jurisdiction to quash an internal revenue summons, as being an unconsented to suit against the United States . . . ." *Application of Howard*, 210 F. Supp. 301, 302 (W. D. Pa. 1962).

with" the present decision (Petition for Certiorari p. 5, *Reisman* v. *Caplin*, Oct. Term 1962, No. 1084).*

In *Reisman*, the District of Columbia Circuit Court held that an action to restrain the Commissioner of Internal Revenue from enforcing a subpoena to third persons under the color of 26 U. S. C. § 7602, but actually in violation of the Fourth Amendment, was beyond the District Court's jurisdiction. The Court there said that "it is not within the court's jurisdiction because it is in substance a suit against the United States to which it has not consented" (317 F. 2d at 125).**

We respectfully submit that the conflict among the circuits on this significant question is a further reason for granting certiorari. And we respectfully request that the Court grant certiorari and set this case down for argument jointly with *Reisman* v. *Caplin*.

2. The Government does not dispute that there is a conflict among the circuits on the proper standard to be applied under 26 U. S. C. § 7605(b) where the IRS seeks to investigate tax years barred by the statute of limitations absent fraud.

---

*The *Reisman* Petition for Certiorari further noted:

> "The jurisdictional facts relied on by the respective plaintiffs in the *Arend*, *Colton* and *Reisman* cases . . . are identical. In all three cases the contention is that the respective Respondents, the individual Special Agent [DeMasters] or the Commissioners directing the Special Agent [Respondent Caplin] in whose very name the subpoenaes were issued (J. A. p. 19), acted unlawfully and beyond their respective Statutory authority" (*Id.* pp. 6-7) (material in brackets in original).

**In its brief in opposition to certiorari in *Reisman*, the Government stated: "The court of appeals held that petitioners' action was barred by sovereign immunity. This holding admittedly raises questions of some difficulty" (Govt. Br. p. 6, *Reisman* v. *Caplin*, Oct. Term 1962, No. 1084). In a footnote to this, the Government added:

> "The Ninth Circuit in *DeMasters* v. *Arena*, 313 F. 2d 79 (Pet. 17a-33a), has suggested in dictum that sovereign immunity does not apply to suits where the taxpayer alleges that the summons was without statutory authorization or was unconstitutional" (*Id.* p. 6 n. 2).

The Government does seem to argue that the cases which reject "the standard adopted by the court of appeals under Section 7605(b)," are not applicable because those cases involve enforcement proceedings. (Govt. Br., pp. 9-10). However, the Government never explains—as it cannot—why the proper standard under Section 7605(b) should be any different in an enforcement proceeding (or a proceeding to quash a summons) than in an action for an injunction to restrain violation of that statute.

The Court below made no such distinction. Indeed, it ruled that the command contained in Section 7605(b) is "unequivocal" (R. 141) and "constitutes a limitation on the power of the tax collecting authorities" (*Ibid.*). The scope of that limitation is the same whether it is raised in an enforcement proceeding: a motion to quash or an action for an injunction.

And we submit that the only proper standard under Section 7605(b)—where the IRS seeks to investigate years closed absent fraud—is whether "there is probable cause or reasonable basis for it to believe that in those years the taxpayer perpetuated a fraud upon the revenue." *O'Connor v. O'Connell*, 253 F. 2d 365, 369 (1st Cir. 1958); *Wall v. Mitchell*, 287 F. 2d 31 (4th Cir. 1961); *U. S. Aluminum Siding Corp. v. Eshleman*, 170 F. Supp. 12 (N. D. Ill. 1958); *McDermott v. John Baumgarth Co.*, 286 F. 2d 864 (7th Cir. 1961).

Moreover, in stating that no Court of Appeals has held this standard to be applicable in an injunction action against the IRS, the Government obviously overlooks *Zimmerman v. Wilson*, 105 F. 2d 583 (3d Cir. 1939), affirming 25 F. Supp. 75 (E. D. Pa. 1938), discussed in our Petition (p. 12).

3. The Government asserts that "petitioners are also not entitled to an injunction against the bank's voluntary decision to disclose information to the Service" (Govt. Br.

p. 6). This assertion is without merit in this case. For one thing, we are here concerned with disclosure pursuant to compulsion of a summons—not voluntary disclosure (*e.g.*, R. 59). Moreover, as noted in our Petition (p. 21), the bank did not respond to the summons and did not appear in this action or contest petitioners' request for the injunction.

4. The Government does not contend that it has shown probable cause to suspect fraud. It does assert that its evidence in the District Court was sufficient to meet the test adopted by the Court of Appeals under § 7605(b) (Govt. Br. p. 10). However, this "evidence" consists solely of "figures" and "estimates" that entered the agent's head (R. 111). And the Government still has not shown how its decision to proceed can be deemed to have been reached as a matter of "rational judgment" (Govt. Br. p. 10) when —as the District Court expressly found—it was not and is not based on "any . . . proper cause" (R. 59).

Respectfully submitted.

JAY H. TOPKIS
Attorney for Petitioners
575 Madison Avenue
New York 22, N. Y.

New York, N. Y.
July 31, 1963

PAUL WEISS RIFKIND WHARTON
& GARRISON

and

GERALD D. STERN
575 Madison Avenue
New York 22, N. Y.

and

MORRIS J. GALEN
Public Service Building
Portland 4, Oregon
Of Counsel